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**The Economy...**  
***A Prelude to Tennessee's***  
***Tax Revenue Estimates***  
**(Fiscal Years 2006-07 and 2007-08)**

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**Presented to: The State Funding Board**

**Presented by: Robert N. Currey, Chief Economist**

**Friday, December 15, 2006**

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# Presentation Outline

- The Conference Board
- Leading Economic Indicators (LEI)
- U.S. Composite Index for the LEI
- The Diffusion Index
- General Economic Outlook
- Expected Revenue Growth

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# The Conference Board

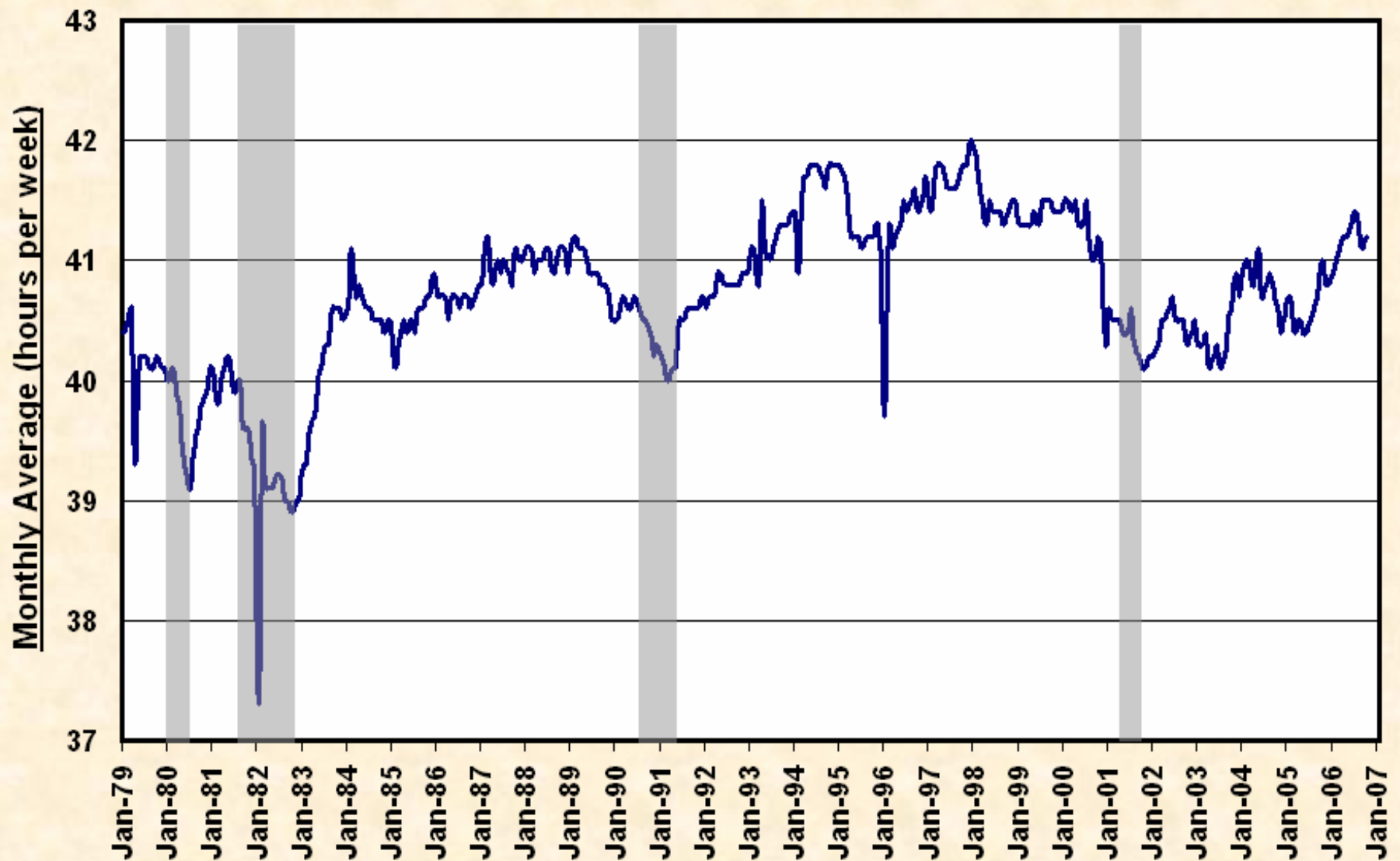
- Publishes *Business Cycle Indicators*.
- Reports on the ten (10) Leading Economic Indicators (LEI).
- Derive the *U.S. Composite Index of LEI* and a *Diffusion Index*.
- Identifies trends used for forecasting economic downturns, as well as recessions.
- Since 1959, these indicators and indices have forecasted downturns/recessions with a high degree of accuracy.
- Typically, economic downturns and/or recessions have lagged sustained negative movement of the indicators/indices from 6 to 18 months.

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# The Leading Economic Indicators (LEI)

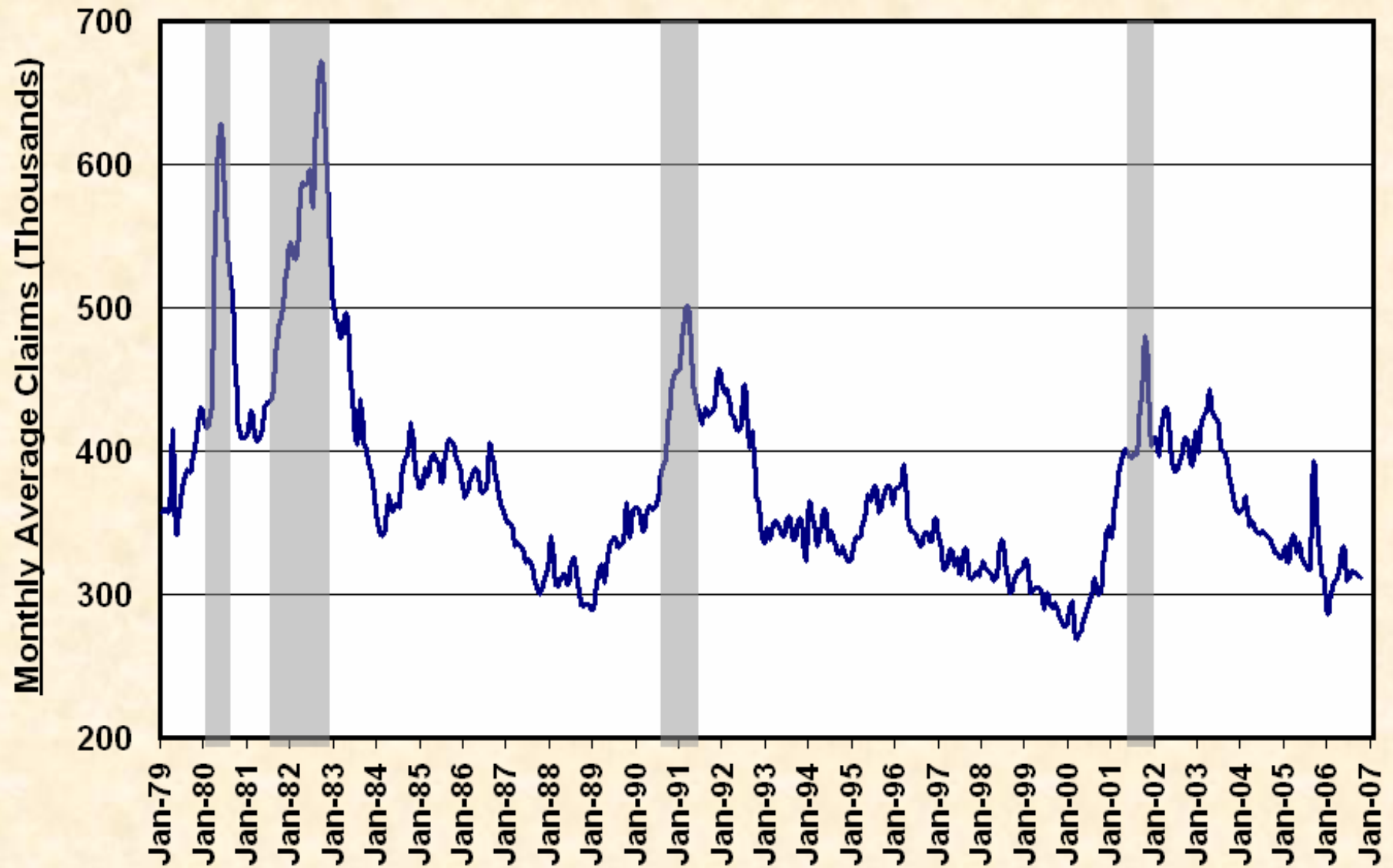
## Average Workweek for Production Workers (hours)

(1)



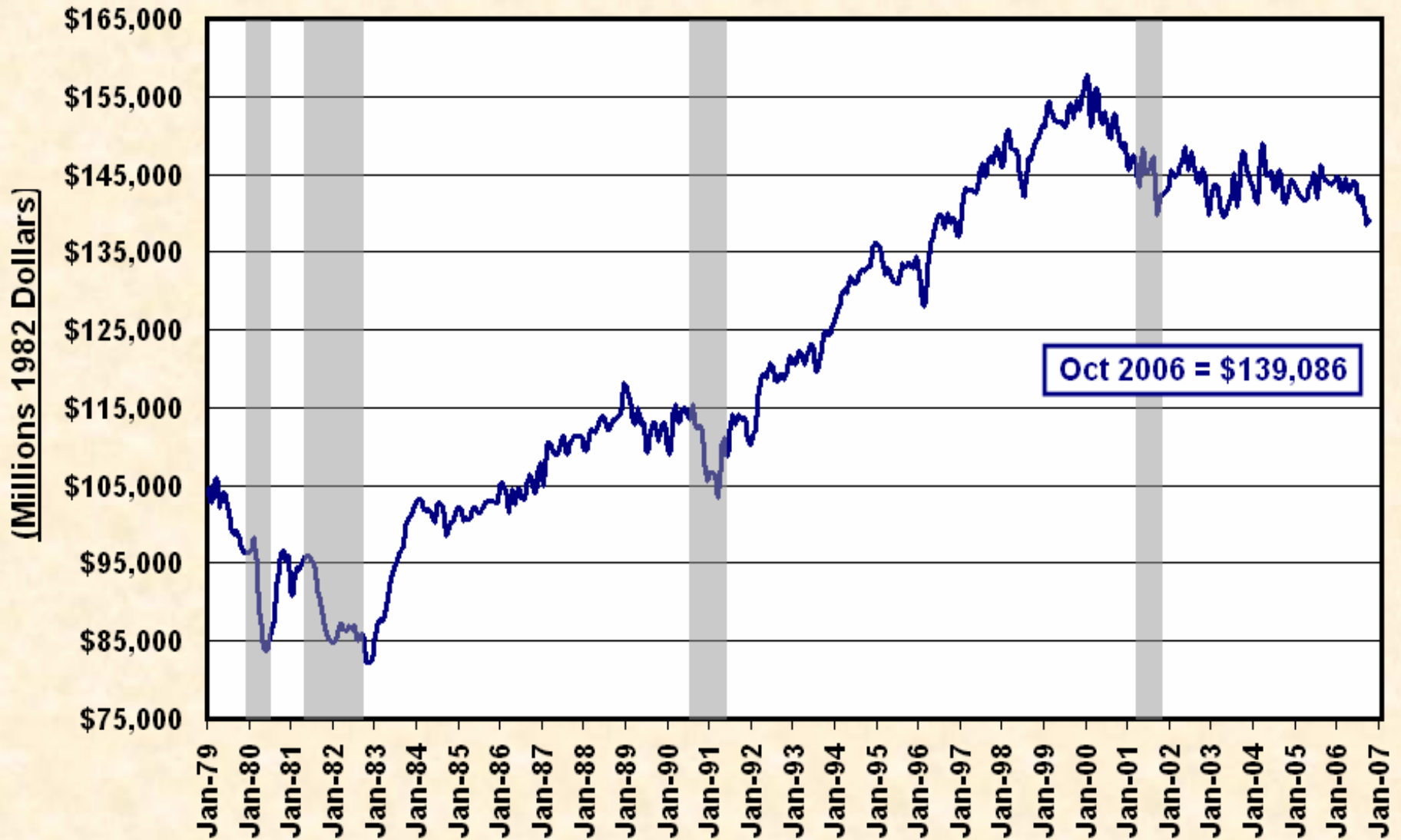
## Average Weekly Initial Claims for Unemployment Insurance

(2)



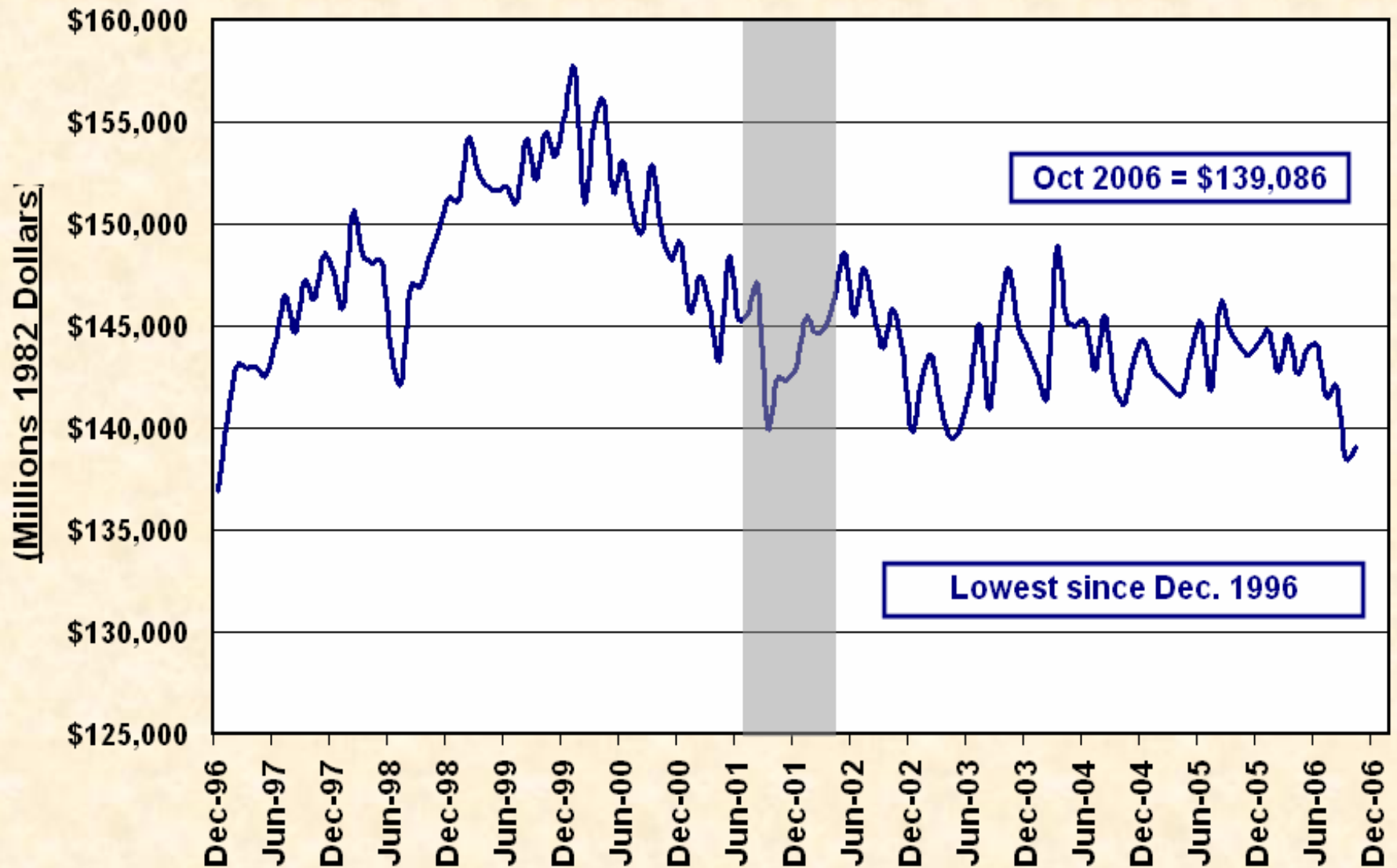
Manufacturer's New Orders -  
Consumer Goods & Materials

(3a)



Manufacturer's New Orders -  
Consumer Goods & Materials

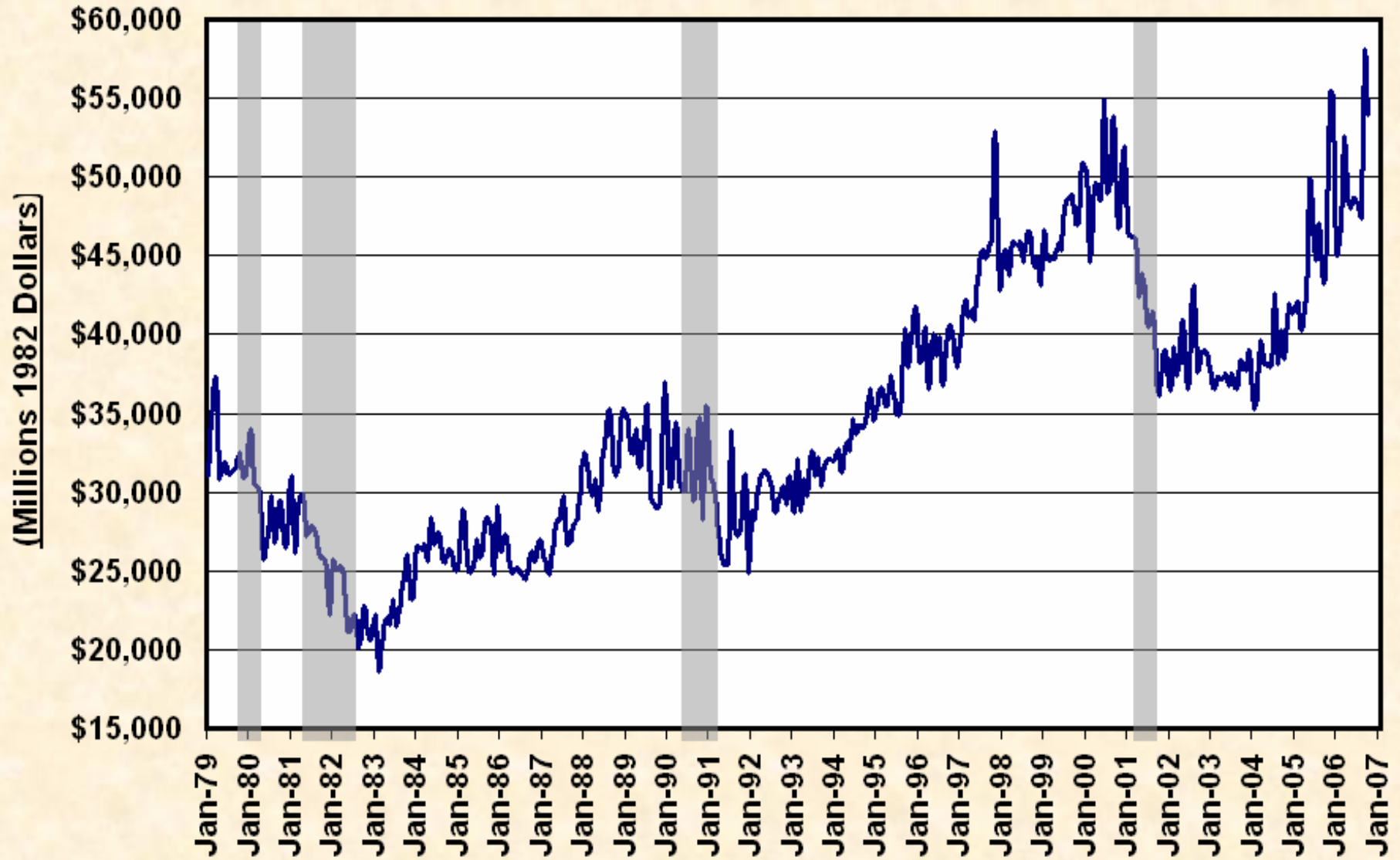
(3b)





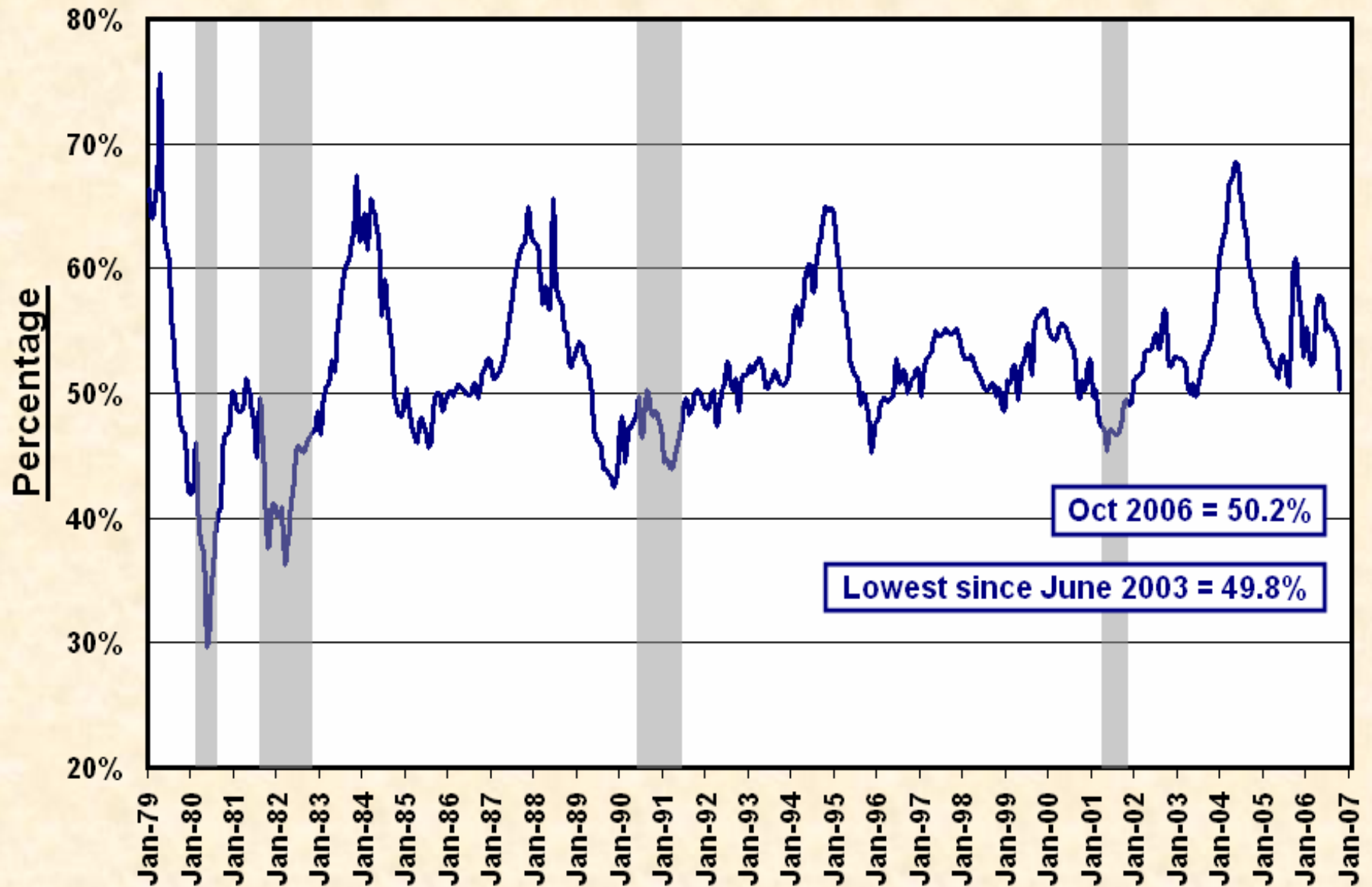
Manufacturer's New Orders -  
Non-Defense Capital Goods

(4)



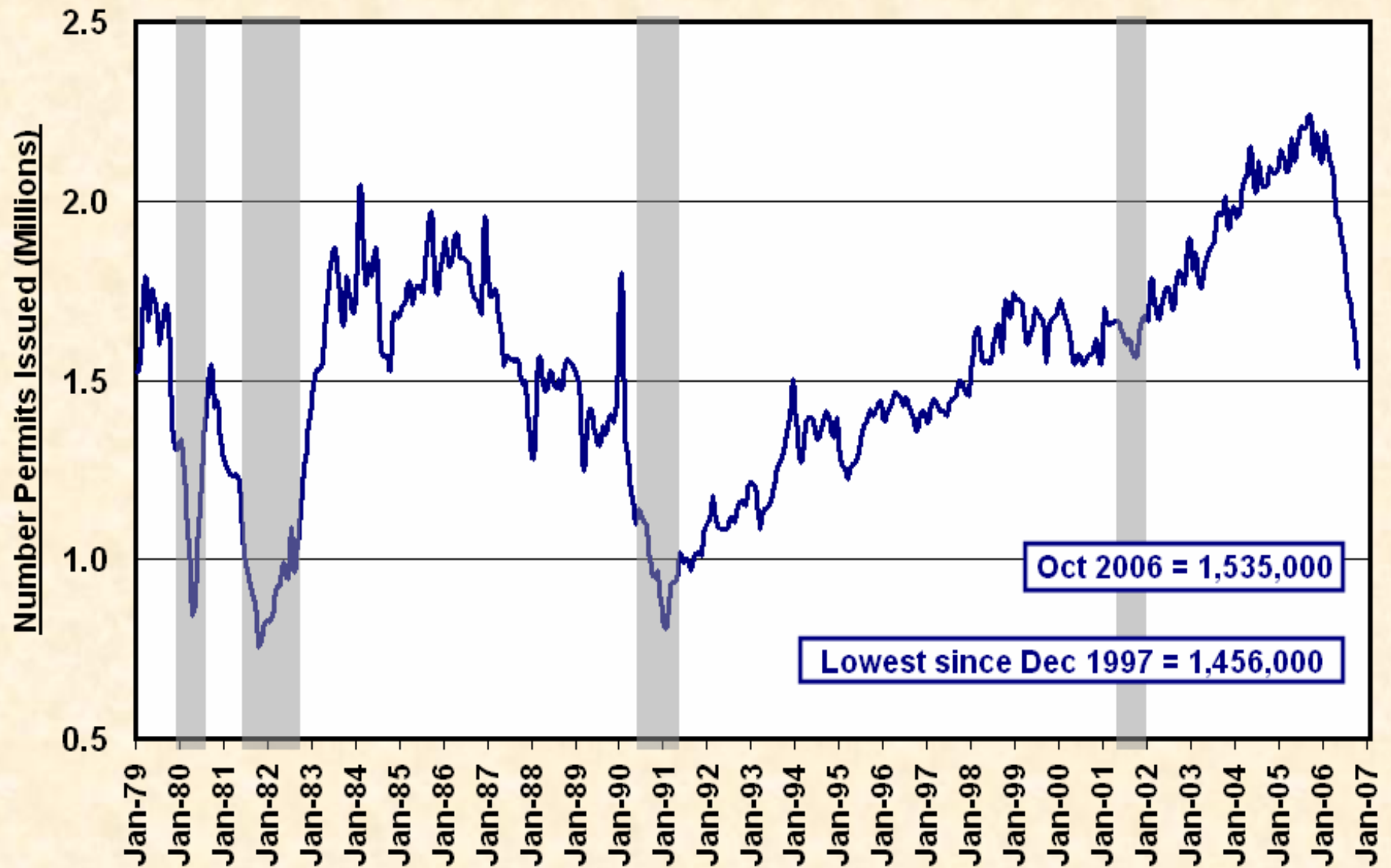
## Vendor Performance - Slower Deliveries

(5)



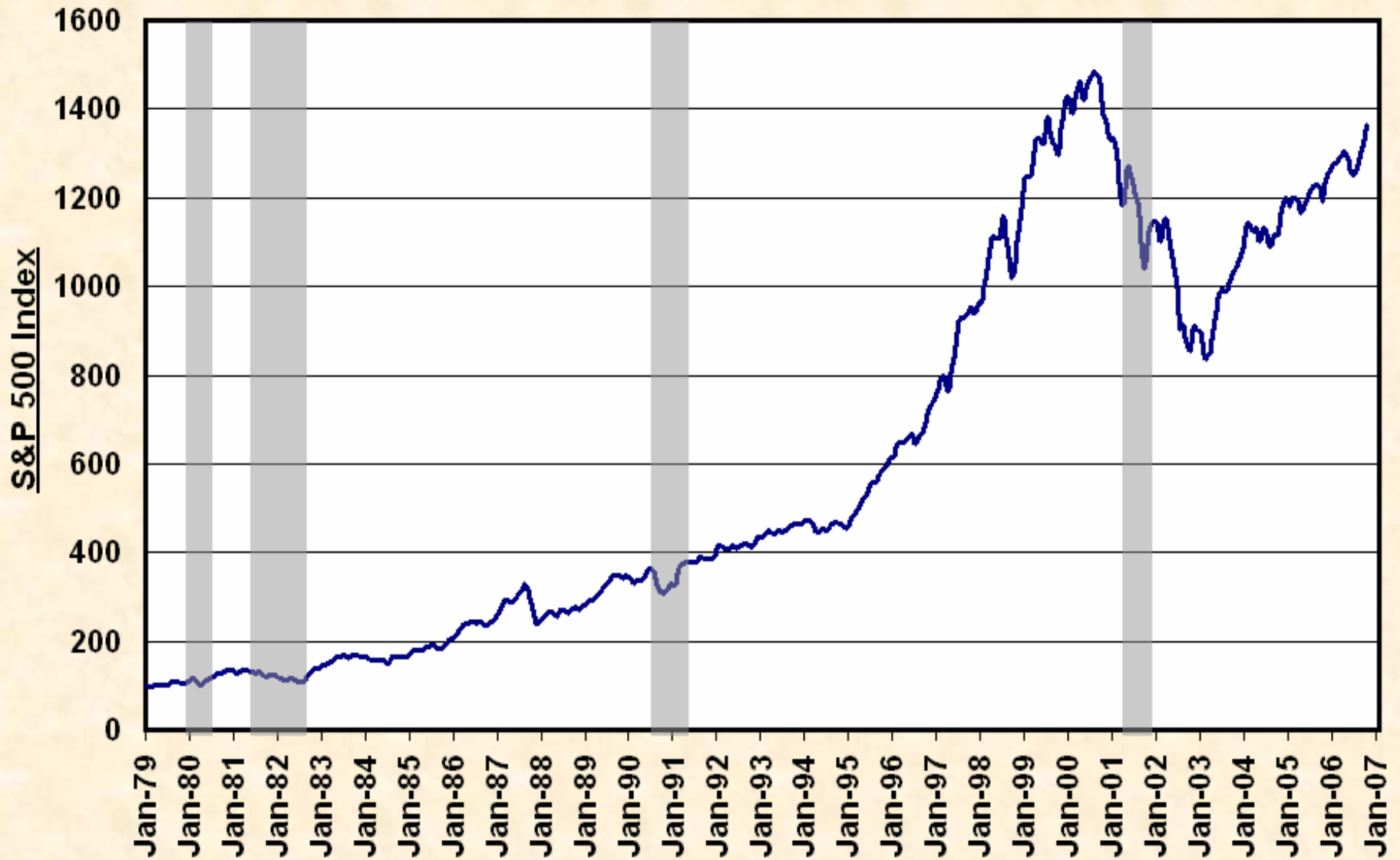
## Building Permits - New Private Housing Units

(6)



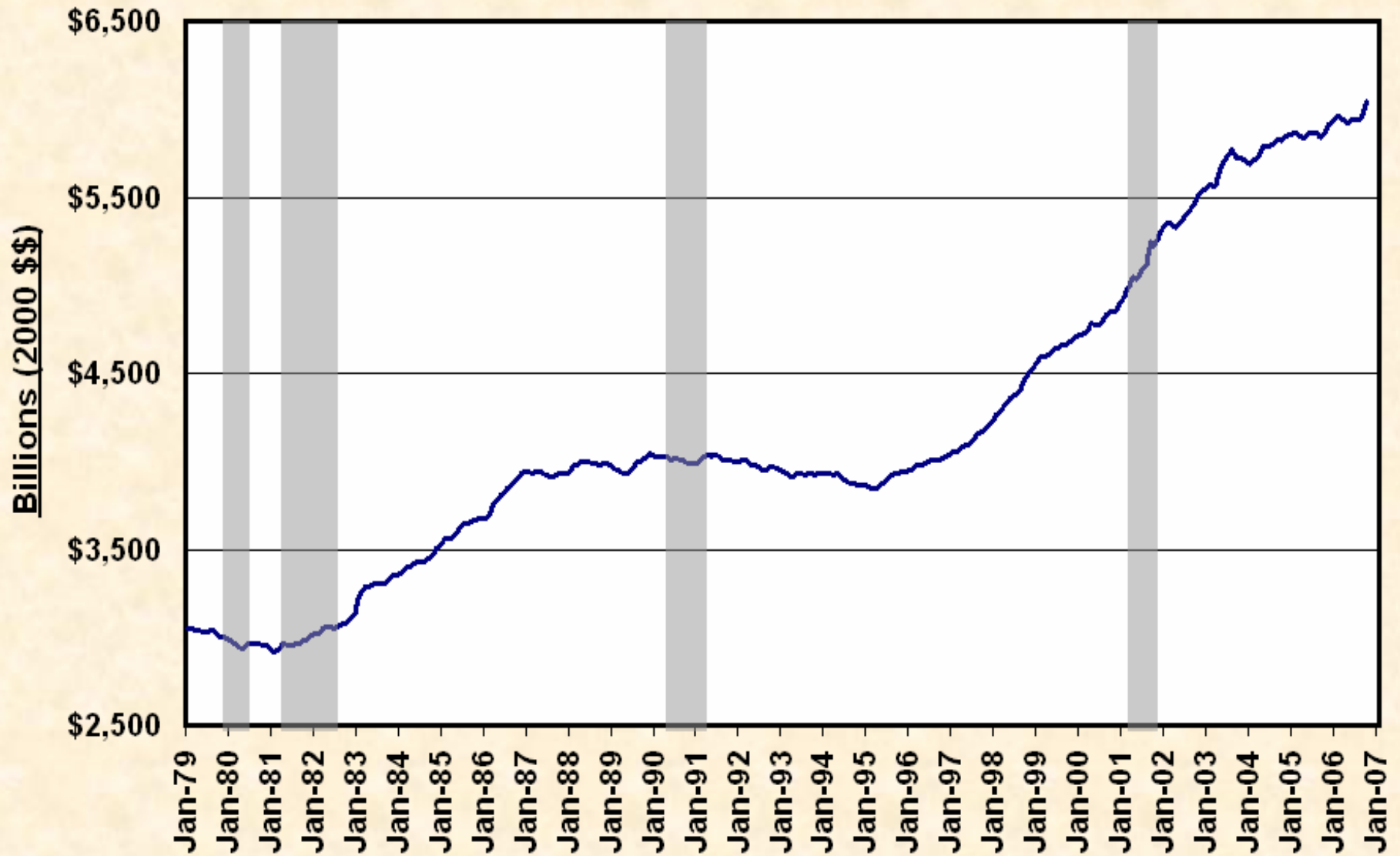
## Stock Prices (S&P 500)

(7)



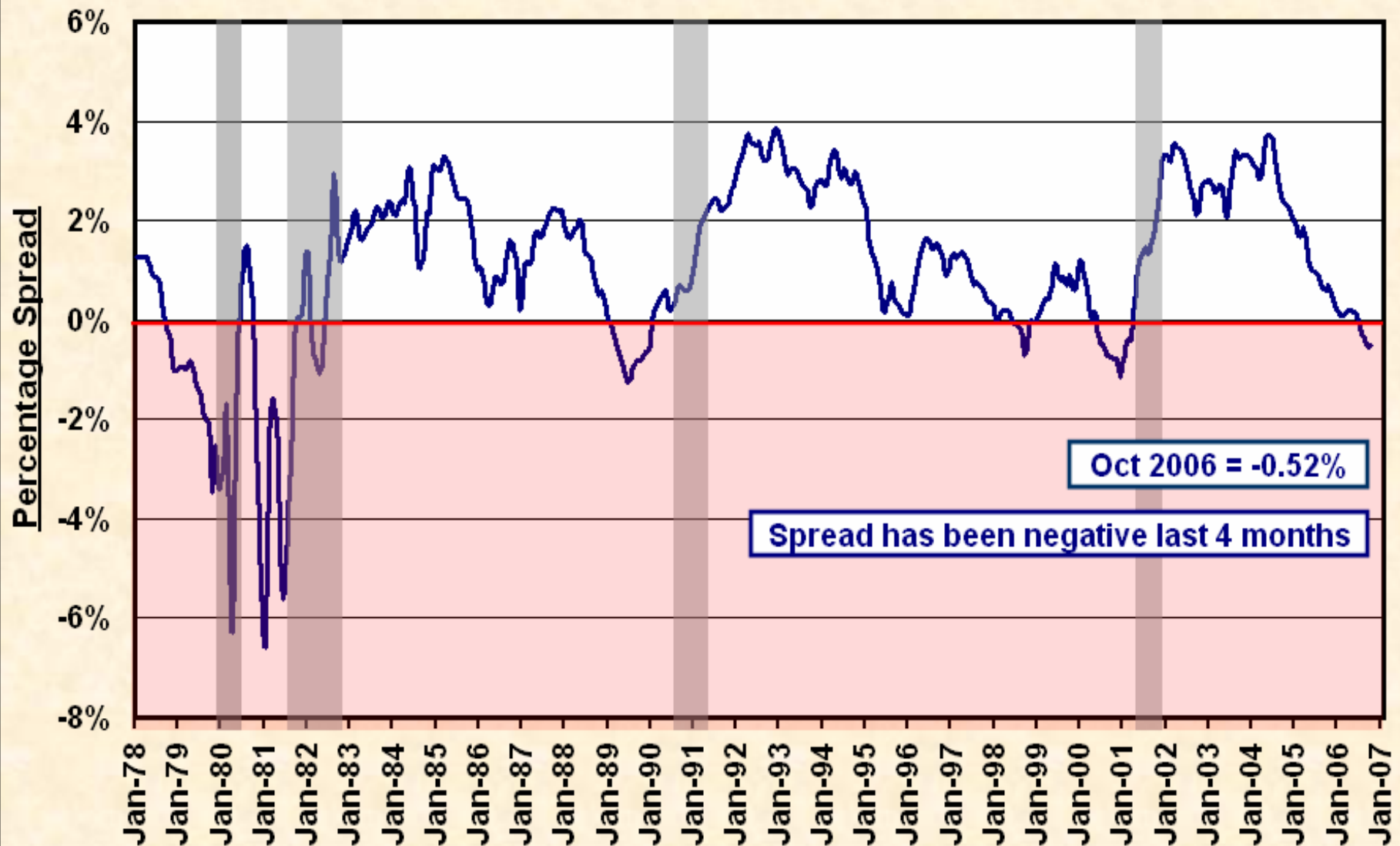
## Real Money Supply (M2)

(8)

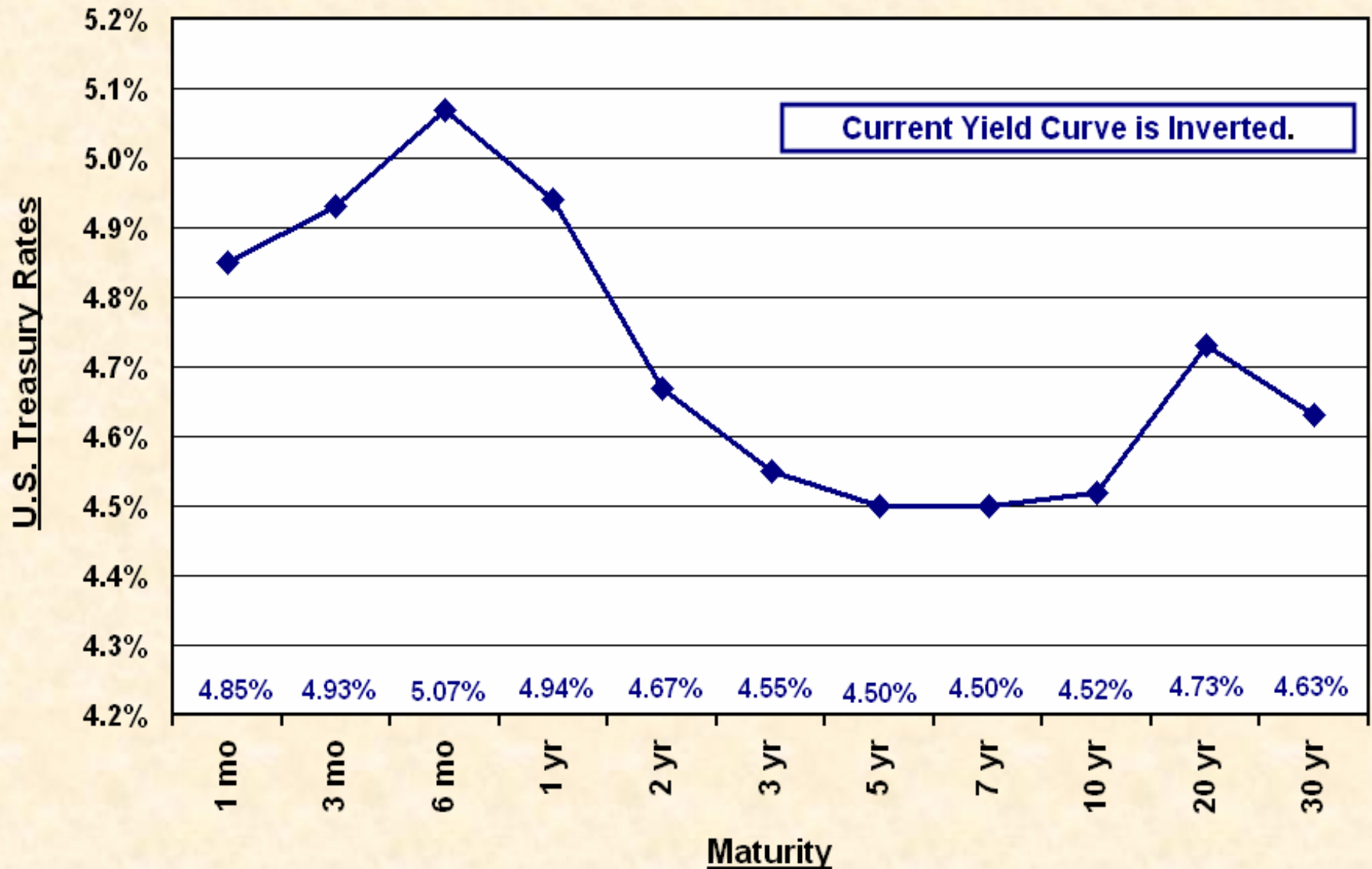


Interest Rate Spread  
(10 Yr. Treasury Bond Rate less the Federal Funds Rate)

(9)

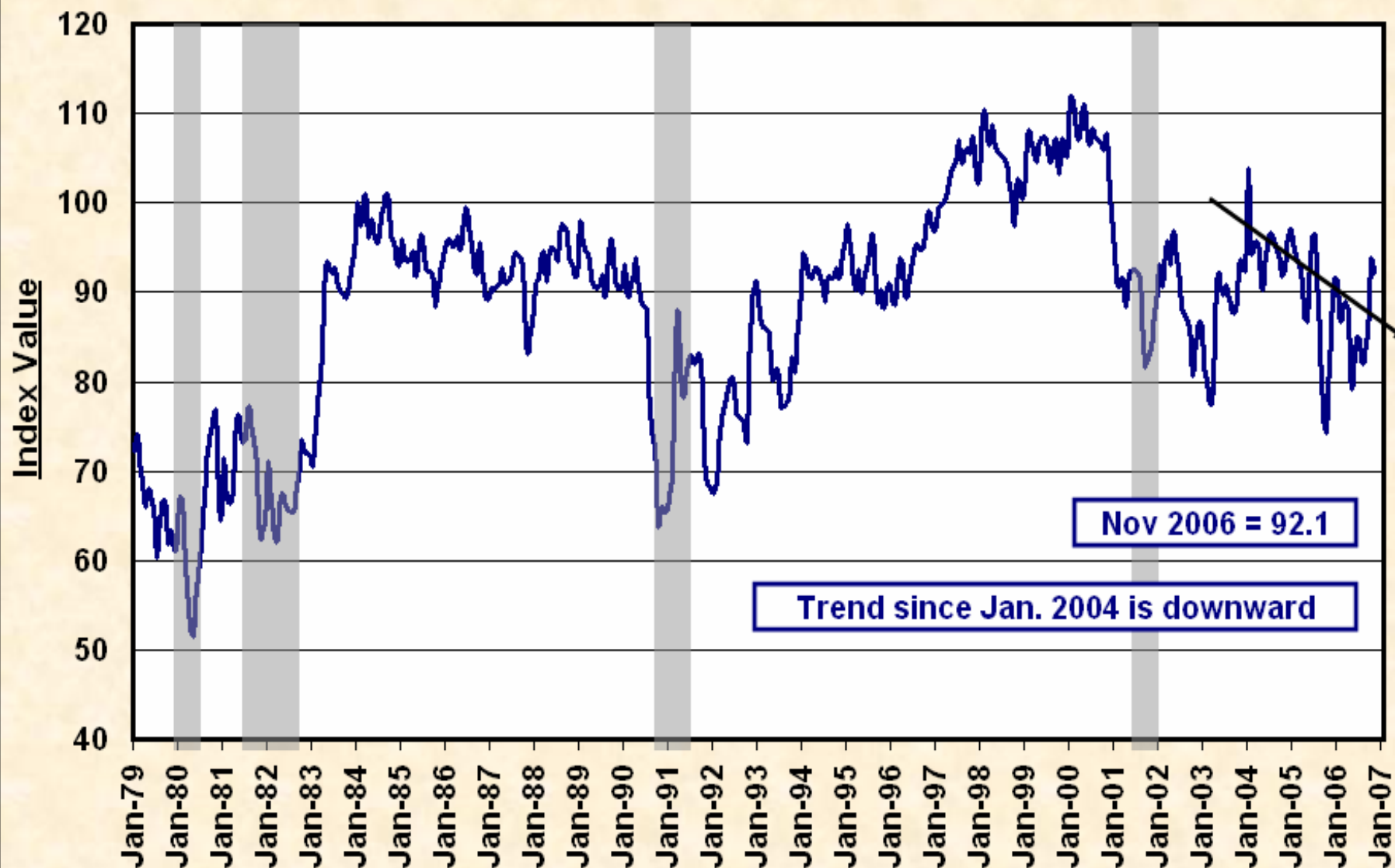


*The Yield Curve (U.S. Treasury Rates)*  
*(as of 12/11/2006)*



Index of Consumer Sentiment (U of Mich)

(10)

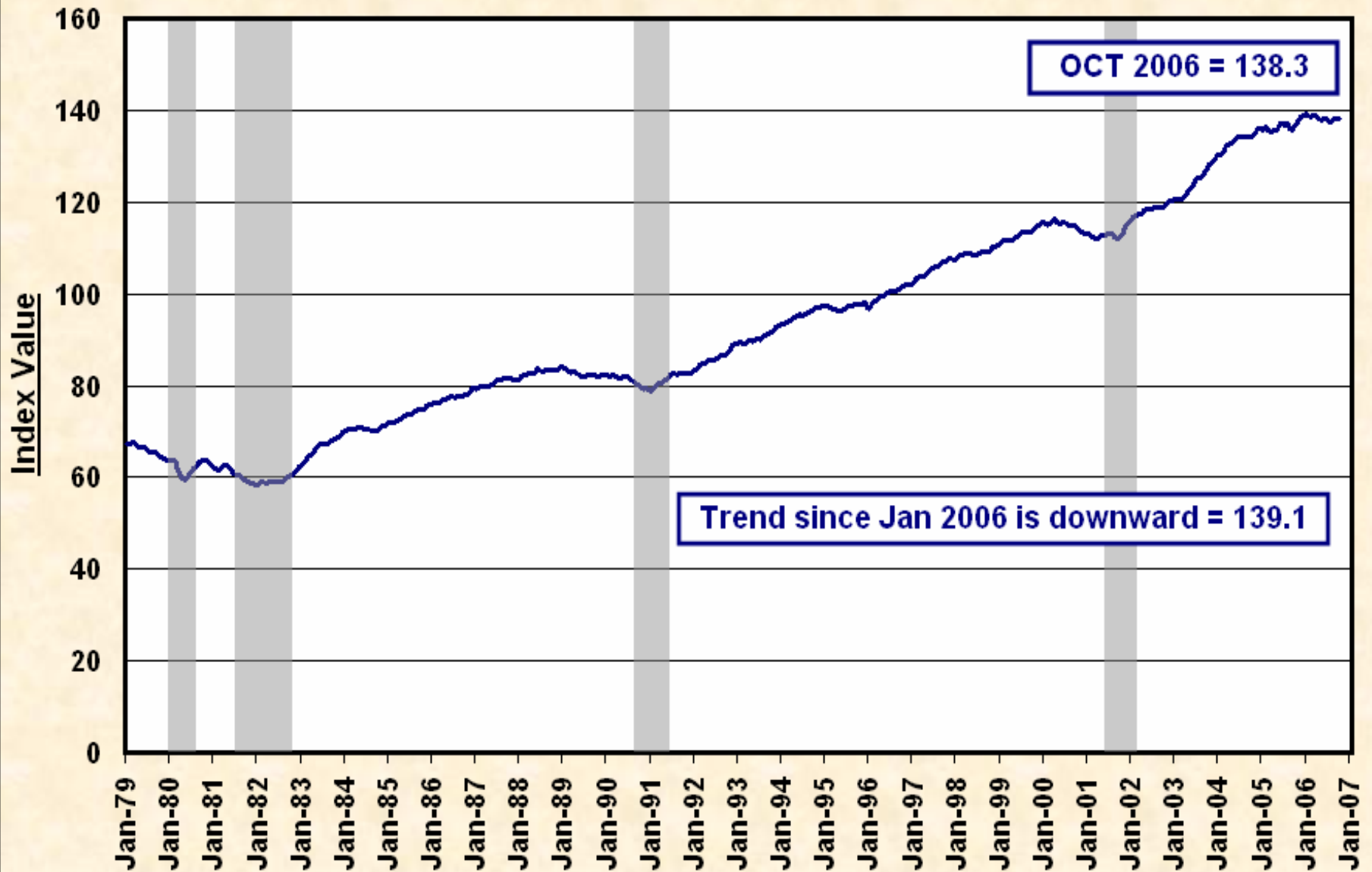




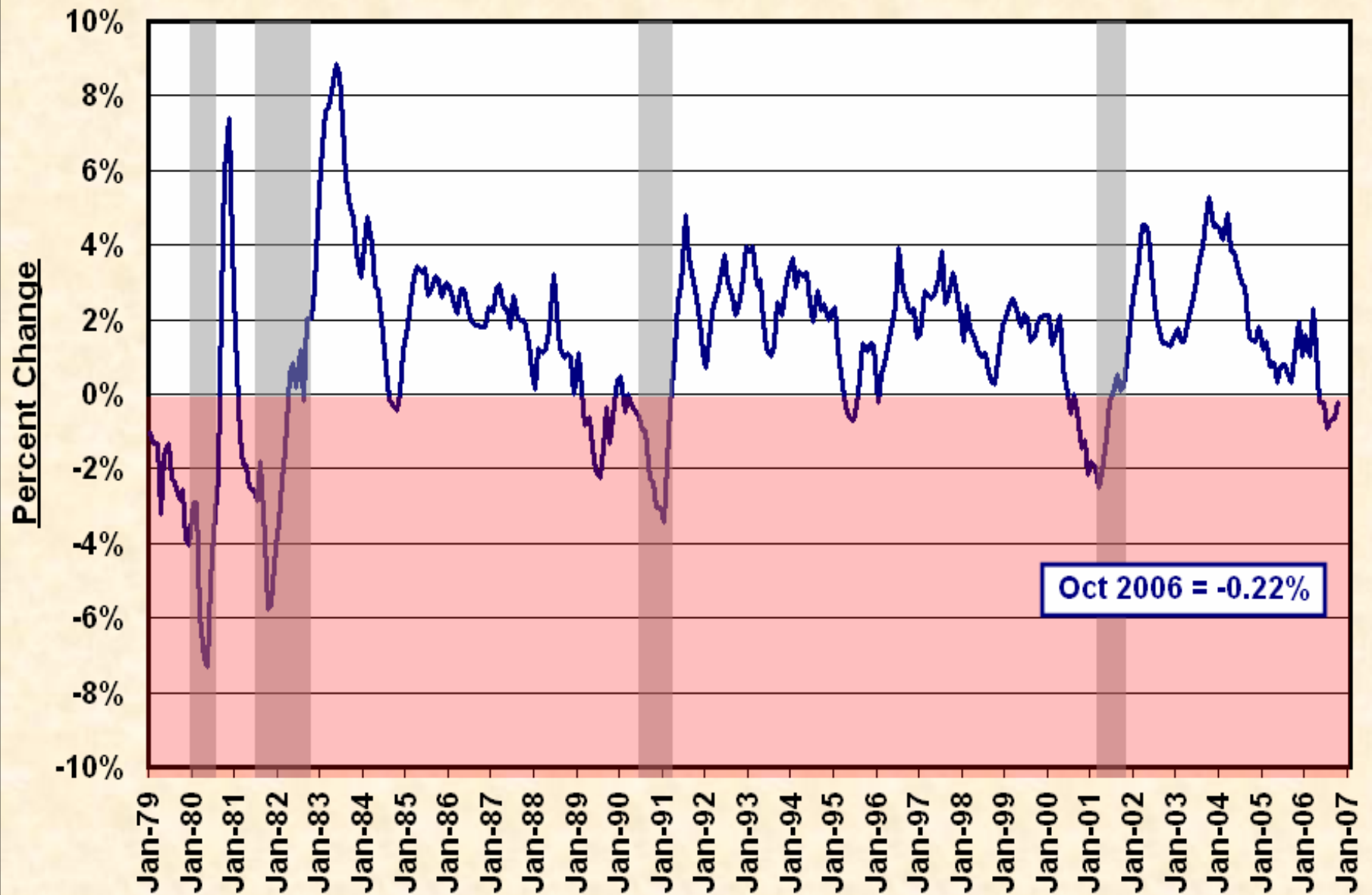
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# The U.S. Composite Index for the Leading Economic Indicators

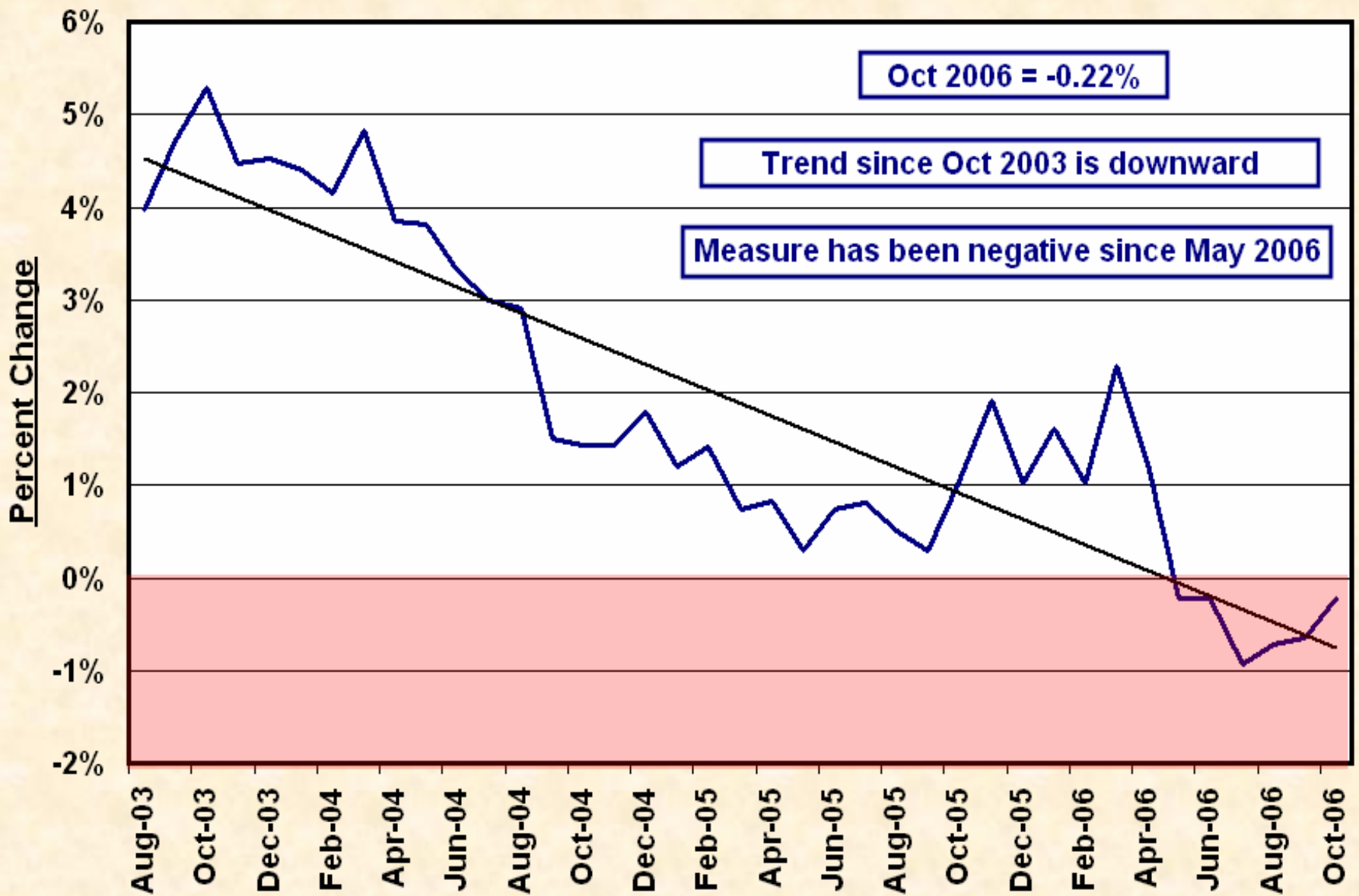
Composite Index of LEI (1996 = 100.0)



### Composite Index of LEI: 6-Month Percentage Change



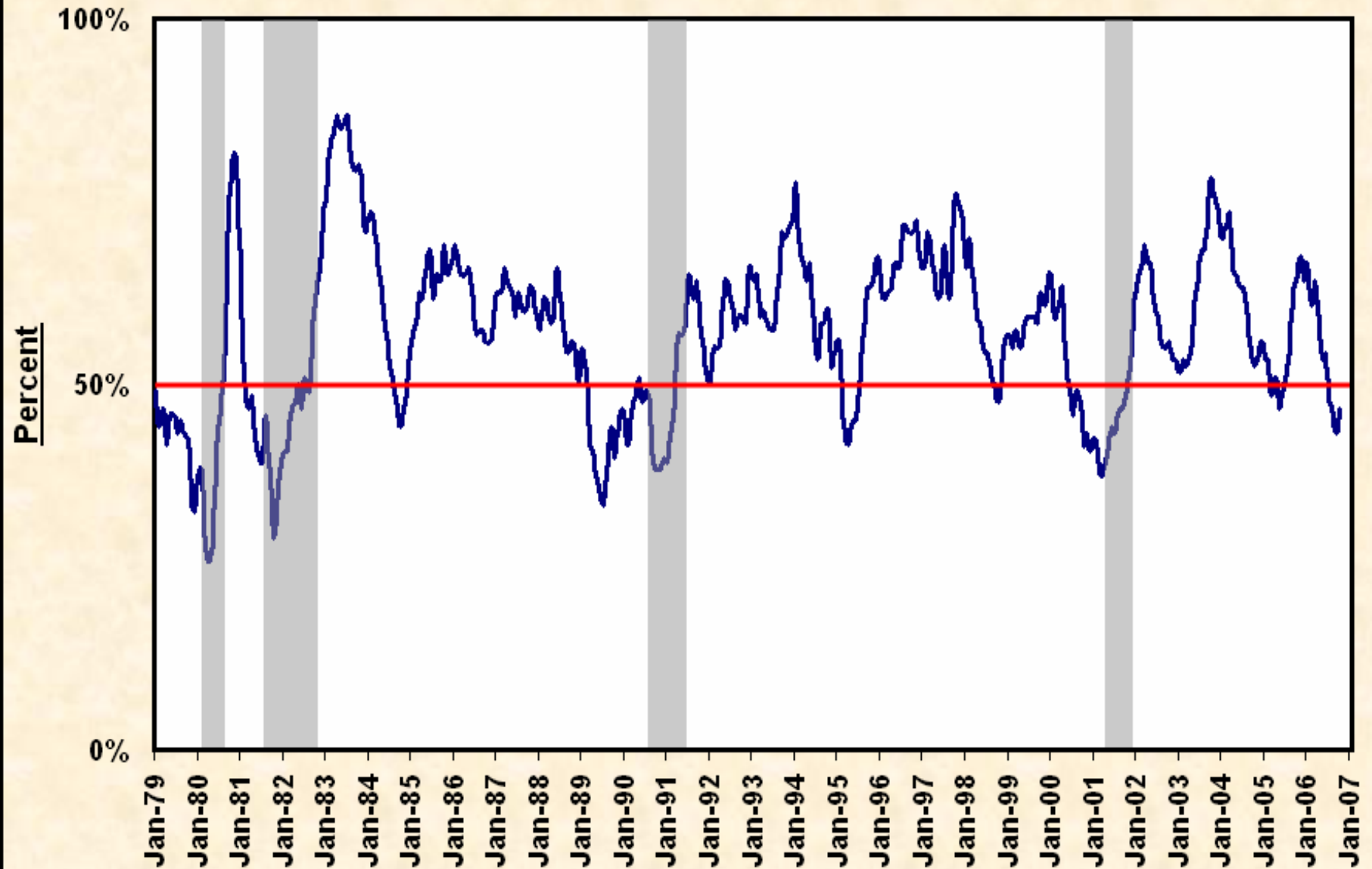
### Composite Index of LEI: 6-Month Percentage Change



# The Diffusion Index...

*...the percentage of LEI  
that are increasing.*

### Diffusion Index (6-Month MA)



# General Economic Outlook

- U.S. economy has and continues to show some signs of a slowdown.
- Slowdown impacting revenue growth to some extent.
- Aug05 → Nov05 = 9.05% (relative to the same period in 2004).
- Led to 6.77% growth in FY05-06.
- Aug06 → Nov06 = 3.70% (over same period in 2005).
- Could this slowdown lead to a recession?
- Indicators are about 50-50.
- GDP still growing...2.2% in Q3 2006.
- Housing market, interest rates & yield curve, composite & diffusion indices.
- Corporate tax revenues (F&E) are extremely volatile, especially in economic slowdowns.

# Expected Revenue Growth

- Warrants “caution” when forecasting.
- What does this mean for our state tax revenues?
- Interpretation: We expect more moderate growth...
- ...less than what we’ve seen over the last two fiscal years.
- FY04-05 actual growth: 5.99%
- FY05-06 actual growth: 6.77%
- FY06-07 estimated growth: 4.31%
- FY07-08 estimated growth: 3.36%